

INTERNAL REVENUE SERVICE
District Director
c/o McCaslin Industrial Park
2 Cupania Circle
Monterey Park, CA 91755-7406

DEPARTMENT OF THE TREASURY

DATE: MAY 13 1996

Employer Identification
Number:

Case Number:

Person To Contact:

Telephone Number:

Refer Reply To:

Dear Applicant:

We have considered your application for exemption from Federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code of 1986.

The information submitted discloses that you were incorporated under the laws of [REDACTED].

The purposes of your organization, as identified in your Form 1023 application, are "...to foster the online [REDACTED] community, expand the number of [REDACTED] online users, and develop innovative [REDACTED] programs and services for the world of [REDACTED]."

Your application identifies your initial activity as the operation of an electronic [REDACTED] forum on [REDACTED], an online service company. While your initial audience will be online users within North America, you will begin targeting other [REDACTED] audiences worldwide once [REDACTED] international service is launched. This is expected to occur within six months to one year from inception. Your intent is to commence operations on [REDACTED] and later replicate and enhance this [REDACTED] forum on World Wide Web (part of the public Internet) and make this forum available through other online services, such as [REDACTED].

FACTS:

Your purpose is "to foster the online [REDACTED] community, expand the number of [REDACTED] online users, and develop innovative [REDACTED] programs and services for the world of [REDACTED]." According to your application, you have proposed to "create a user-friendly, computer-based communication vehicle for the [REDACTED] community" that will serve as "...a vehicle specifically designed to carry the messages and encourage the dialogues necessary to create bonds between the younger [REDACTED] and the [REDACTED] community."

In operating your electronic [REDACTED] forum on [REDACTED], your application indicates that "In each area there will be bulletin boards, chat schedules, relevant text, downloadable graphics, sound and text, games and contests, and a marketplace."

Correspondence dated [REDACTED] from your representative identifies the following topics or "areas" to be presented in your forum:

- Arts and Culture
- Youth (including a downloadable library containing educational [REDACTED] software as well as an extensive message board)
- [REDACTED] (consisting of a daily compilation of important [REDACTED] information)
- [REDACTED] (featuring a variety of publications pertaining to [REDACTED])
- Food (including information on [REDACTED])
- Education (including courses in [REDACTED] and downloadable [REDACTED])
- [REDACTED] (including material on the [REDACTED] political system and information on the history of the state of [REDACTED])
- Family and Educational Matters
- Holidays and Spirituality
- [REDACTED] (comprising a singles service that provides the opportunity for [REDACTED] to find [REDACTED] mates)
- [REDACTED] (providing information pertaining to historical and religious matters)
- [REDACTED] (also entitled "[REDACTED]")
Consisting of online shopping for goods offered by mail order companies providing the following categories of sales items:

- religious items
- religious and educational books
- [REDACTED] music
- [REDACTED] food
- Travel Service (including information on travel sites)
- Job Listings (providing a free service in which job opportunities in nonprofit organizations will be listed)
- Advertising and Sponsorship

The posting of classified ads will include the above mentioned job listings. Additionally, your organization will allow the posting of personal ads by singles to allow them to correspond via e-mail, chat online or communicate through a 900 number.

It was established in a letter dated [REDACTED] from your representative that your organization will restrict its sale of goods to the four categories of products identified above. It was also stated in the same letter that no travel services or trips will be sold. Both assertions supercede the remark appearing in your application that "An interactive store/catalog will sell [REDACTED] books, [REDACTED] travel arrangements and other merchandise to customers."

With respect to the operation of the [REDACTED], it was further stated in a letter dated December 4, 1995 from your representative:

"...we believe that virtually all of the items which are going to be sold by the [redacted] do not generate unrelated business taxable income, much less cause the Corporation to be non-exempt under section 501(c)(3). On the other hand...if the IRS determines that the sale of certain items by the Corporation will cause the Corporation to fail to qualify as tax exempt under section 501(c)(3), the Corporation is willing to provide those services through a for-profit, wholly owned subsidiary of the Corporation."

Six primary sources of revenue have been identified in your application, as follows:

- 1) grants and contributions
- 2) funds received from [redacted] based on a percentage of connect time charged to [redacted] members within [redacted] area
- 3) rebates from [redacted] for every new member/customer recruited by your organization via your promotions and "aggressive marketing efforts and partnering with other [redacted]"
- 4) a percentage of the gross sales generated by online shopping purchases
- 5) income from classified and personal advertising
- 6) sponsorship/advertising revenue

Revenue will be derived from the [redacted] in the form of nominal service fees that will be charged to cover the production costs involved in presenting [redacted].

According to computations derived from the figures provided in your proposed budgets for 1995/1996 through 1998/1999, your organization will receive approximately [redacted] percent of its total revenue from [redacted] in the form of connect time and the [redacted]. An additional [redacted] percent of your total revenue will be received from [redacted] in the form of classified ads, personal ads, sponsors and advertisers.

Revenue to be derived from classified ads, personal ads, sponsors and advertisers featured on the World Wide Web will comprise another [redacted] percent of your total revenue.

A letter dated [redacted] from your representative indicates that products offered will not be sold at prices above normal retail prices and that vendors will be selling the products for the same prices as set forth in their catalogues and/or stores. Your organization anticipates receiving [redacted] percent of the selling price of each item. Such revenue will be used, in part, to process the item requests to the vendors.

Your proposed expenses include the payment of salaries, employee benefits and compensation for professional services. The costs associated with maintaining a facility and establishing an [redacted] are also identified. Promotion and content costs are identified as well.

In conducting your activities, your organization will have dealings with numerous types of entities. The terms of such relationships are set forth in the following paragraphs.

The terms of your corporate sponsorship are addressed in your representative's letter dated [REDACTED]. According to this letter, corporations will be able to sponsor areas of the forum in a manner similar to that by which corporations sponsor public radio and television. In return for the corporation's contribution, the corporation's name will be listed as a sponsor of a given area of the forum. There will be no other benefit to the corporate sponsor and the corporate sponsor will generally not be permitted to advertise on the forum. (In a letter dated [REDACTED] from your representative, it was stated that "Advertising and sponsorship revenue will come solely from advertisers of [REDACTED] who are sponsoring in an area within the forum.")

In regards to online shopping, your organization has already chosen the vendors who will fill the mail orders. The vendors were selected on the basis of their compatibility with your organization's vision of the services that need to be provided on the forum, their current mail order capabilities and the fact that the vendors sell only educational, religious and [REDACTED]. None of the vendors are, in any way, related to your organization's Board of Directors. These details were supplied in your representative's letter dated [REDACTED].

According to the above mentioned letter, there will be more than fifty information providers who will submit material for presentation on [REDACTED]. Except for [REDACTED], none of these information providers are related to your organization's Board of Directors. [REDACTED] will serve as the information newsstand along with many other [REDACTED]. [REDACTED] will not benefit from your organization's activities or be compensated for such information. None of the information providers will receive monetary compensation for their information but will, instead, receive from your organization the [REDACTED] in those instances in which an information provider uses [REDACTED] to provide your organization with information. Additionally, the contribution of the information provider will be recognized via copyrights.

Section 2 of Article III of your Bylaws indicates that [REDACTED] shall appoint no more than [REDACTED] percent of your Board of Directors. Until your organization has sufficient revenue to support its own employees, your organization will contract with [REDACTED] to provide necessary services. Your proposed budgets indicate that [REDACTED] will donate \$[REDACTED] to your organization during your first year of operation.

[REDACTED] is a nonprofit corporation whose stated purposes, according to the Second Article of its Articles of Incorporation, are:

"...to acquire, own, issue, publish and/or distribute newspapers, magazines, and/or publications of any and all sorts for and of interest to [REDACTED]"

[REDACTED] is a nonprofit entity but it is not tax exempt under Code section 501(c)(3).

The proposed terms of your organization's agreement with [REDACTED] are identified in the document entitled "[REDACTED]" between [REDACTED] and [REDACTED] dba [REDACTED]. (As explained in your representative's letter dated [REDACTED], [REDACTED] is also known as [REDACTED]. Throughout the "[REDACTED]" (also referred to as "[REDACTED]"), [REDACTED] is variously referred to as the "[REDACTED]", "[REDACTED]" and "[REDACTED]").

Section 2.1.9 of the Agreement stipulates that the [REDACTED] shall "assign and transfer this Agreement and all of its rights and obligations hereunder to [REDACTED] as soon as practicable after [REDACTED] is granted tax exempt status as a 501(c)(3) entity."

Section 2.1.2 of the Agreement establishes that [REDACTED] shall have exclusive rights to the licensed content and services for six months from the date of launching the online area. Section 2.1.7 of the Agreement outlines the minimum that is expected of the [REDACTED] in fulfilling its responsibilities to make commercially reasonable efforts to market the online area. Furthermore, Section 6.2 of the Agreement requires the [REDACTED] to "agree" not to promote on or through the [REDACTED], the online services of any other entity which could reasonably be construed to be in competition with [REDACTED]."

In accordance with Section 3.1 of the Agreement, [REDACTED] shall pay the [REDACTED] percent of all Hourly Usage Revenue, i.e., connect time revenues, and a fee of [REDACTED] dollars for each New Member. (A New Member, as defined, in part, in section 1.9 of the Agreement, as "any person or entity who registers for the [REDACTED] using [REDACTED]'s special promotion identifier...")

In Section 3.2 of the Agreement, it is set forth that the Information Provider shall pay [REDACTED] percent of all advertising revenues to [REDACTED]. In addition, the [REDACTED] shall pay [REDACTED] percent of all sales revenues, excluding revenue derived from the sale, distribution or provision of newspapers, books or magazines. With respect to revenue collected from the sale, distribution or provision of newspapers, books or magazines, the [REDACTED] shall pay [REDACTED] the greater of (a) [REDACTED] percent of all sales revenues derived therefrom or (b) a percentage equal to the percentage received by the [REDACTED] in connection with the sale, distribution or provision of the newspaper, book or magazine.

Section 2.1.1 of the Agreement sets forth the terms of the relationship between the [REDACTED] and [REDACTED]. [REDACTED] will contract with and manage technical processes for entities that are interested in providing information content to the forum. [REDACTED] will provide a contract template that the [REDACTED] will use in contracting with [REDACTED]. Any contracts between the [REDACTED] are subject to review and approval by [REDACTED].

With respect to whether the above terms are representative of agreements between [REDACTED] and other nonprofit organizations, a letter submitted by an account manager of [REDACTED] confirms that the terms are consistent with those between [REDACTED] and other nonprofit organizations. Additionally, the percentage of usage royalties that [REDACTED] receives as a result of its contract with [REDACTED] is consistent with those received from [REDACTED] other non-profit (as well as for-profit) partners.

Your representative's letter dated [REDACTED] asserts that none of your Board of Directors are, in any way, related to [REDACTED].

LAW:

Section 501(c)(3) of the Internal Revenue Code describes certain organizations exempt from income tax under section 501(a) and reads, in part, as follows:

"(3) Corporations, and any community chest, fund or foundation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distribution of statement), any political campaign on behalf of any candidate for public office."

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 513(c) of the Internal Revenue Code defines a trade or business as follows:

"For purposes of this section, the term 'trade or business' includes any activity which is carried on for the production of income from the sale of goods or the performance of services. For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the

exempt purposes of the organization. Where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit."

Trade or business has the same meaning that it has for the purpose of determining whether a particular expense is a deductible trade or business expense under Internal Revenue Code section 162 and includes any activity carried on for the production of income from the sale of goods or in the performance of services. See Regulations 1.513-1(b).

Section 1.502-1 states that "...In the case of an organization operated for the primary purpose of carrying on a trade or business for profit, exemption is not allowed under section 501 on the grounds that all profits of such organizations are payable to one or more organizations exempt from taxation under section 501. In determining the primary purpose of an organization, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of those activities of such organization which are specified in the applicable paragraphs of section 501." Organizations whose purposes are religious, but whose operations are nonetheless conducted in a commercial manner, do not qualify for exemption. For instance, the commercial character of religious publishing operations has been cited as a basis for denial of exemption in numerous rulings. See Incorporated Trustees of the Gospel Workers Society v. U.S., 520 F. Supp. 374 (D.D.C. 1981); Scripture Press Foundation v. United States, 285 F. 2d 800 (1961), cert. den. 363 U.S. 985 (1962), and The Foundation for Divine Meditation, Incorporated v. Commissioner, T.C. Memo 1965-77.

In Living Faith, Inc. v. Commissioner, 60 T.C.M. (1990), the Court ruled that the organization's vegetarian restaurants and health food stores were not operated exclusively for an exempt purpose. The organization's activity was conducted as a business and was in direct competition with other restaurants and health food stores. Furthermore, the sale of the health foods was sufficiently substantial that it could not be said that the organization operated exclusively for religious purposes. The organization also failed to demonstrate that the operations were required to further the dietary teachings of the Seventh Day Adventist Church or necessary to enable members of the Church to comply with the beliefs. Accordingly, the organization was not granted exemption.

The Supreme Court stated in Better Business Bureau v. United States, 326 U.S. 279, 66 S. CT. 112, 90 L Ed. 67 that "...the presence of a single (noncharitable) purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly (charitable) purposes."

The above ruling applies to entities that are organized and operated for any exempt purpose, including a religious purpose or both religious and educational purposes. In Fides Publishers Association v. United States, 263 F. Supp. 924 (1967), it was determined that there was a substantial non-exempt purpose in the organization's publication and sale of religious literature, and exemption was thereby denied.

In all of the following court cases, it was held that the presence of a single non-exempt purpose and the conducting of substantial non-501(c)(3) activities results in loss of exemption, despite the presence of other exempt purposes: Church of Boston v. Commissioner, (1978) 71 T.C. 102; Best Lock Corporation, (1959) 11 T.C. 1217; St. Louis Science Fiction Limited v. Commissioner, T.C. Memo 1985-162; Colorado State Chiropractic Society, (1989) 93 T.C. 487, and Minnesota Kingsmen Chess Association Inc. v. Commissioner, T.C. Memo 1983-495.

Revenue Rulings 71-504 and 71-505 both denied exemption under section 501(c)(3) because the organizations in question conducted substantial non-501(c)(3) activities.

As demonstrated by the following rulings, conducting social and recreational activities in conjunction with religious and educational activities may preclude exemption under Code section 501(c)(3).

The Tax Court concluded in The Schoeger Foundation v. Commissioner, 76 T.C. 380 (1981) that the organization failed to demonstrate that it operated primarily for an exempt religious purpose and that its recreational and social activities were merely incidental to its religious purpose.

Similarly, the failure of an organization to establish that it was operated exclusively for religious and educational purposes, in spite of its accompanying social and recreational activities, resulted in denial of exemption as described in Revenue Ruling 77-366.

Furthermore, in First Libertarian Church v. Commissioner, 74 T.C. 396 (1980), the Court held that the organization did not qualify for exemption because it failed to show that it segregated the social and political aspects of its activities from its stated religious purpose.

In order to qualify for exemption under Code section 501(c)(3), an organization must serve a public rather than a private benefit. Although an incidental private benefit will not destroy the qualification of an otherwise religious and educational organization, where an organization is serving both public and private interests, the private benefit must be clearly incidental to the overriding public interest. See Benedict Ginsberg v. Commissioner, 46 T.C. 47 (1966).

Revenue Ruling 76-206 describes a nonprofit organization formed to generate community interest in the retention of classical music programs presented by a local for-profit radio station. The nonprofit organization achieved its purpose, in part, by seeking program sponsors, urging the public to patronize the sponsors, and nonprofit organization's board of directors did not include any representatives of the for-profit radio station. In addition, the organization received most of its support from the general public. It was determined that the organization's activities constituted a public relations campaign on behalf of the for-profit radio station. The organization's efforts allowed the radio station to increase its total revenue. The increase in the size of the

listening audience that would likely occur as a result of the nonprofit organization's efforts would enhance the value and salability of the station's airtime. It was concluded that the organization's activities served to benefit the for-profit radio station in more than an incidental manner and, therefore, the organization did not qualify for 501(c)(3) exemption.

ANALYSIS:

The Code sections, Regulations sections and court cases described in the preceding paragraphs identify the criteria considered in determining whether an organization may qualify for exemption under section 501(c)(3) of the Internal Revenue Code.

While much of the content of your forum might be regarded as religious and educational in nature and, therefore, consistent with Code section 501(c)(3) purposes, you will also provide opportunities for persons to engage in [redacted] for certain goods. Additionally, social and recreational activities will be introduced via games and contests as well as the posting of personal ads by singles to allow them to correspond via e-mail, chat online or communicate through a 900 number. Classified ads, including [redacted], will also be posted. Such activities do not serve exclusively 501(c)(3) purposes.

The purpose of a 501(c)(3) entity must be to provide public benefit; any private benefit derived from its activities must be merely incidental to the purposes of the organization. However, substantial private benefit will be derived from your proposed efforts to recruit and retain [redacted] members as well as through your possible association with existing mail order businesses in offering online shopping. Although your organization has proposed to later expand its operations so as to offer your [redacted] through additional online service companies, such expansion would only compound the problem by multiplying the private benefit enjoyed by commercial interests within the online service industry.

The commercial nature of much of your operations is apparent from the terms of the agreements between your organization and [redacted], as well as the mail order vendors. Such commercialism is clearly incompatible with 501(c)(3) exemption.

It was suggested that your organization could achieve its religious and educational purposes by obtaining a Web site, charging a nominal subscriber's fee and restricting the content of your forum to subject matter that is exclusively religious and/or educational in nature. The organization declined this specific suggestion.

CONCLUSION:

To be considered for tax exempt status under section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in that section. Also, its activities must be restricted to those permitted a section 501(c)(3) organization.

Based on the information submitted, we have concluded that you are not entitled to exemption from Federal income tax as an organization that is described in section 501(c)(3) of the Code, inasmuch as you are not "operated exclusively" for one or more of the specified purposes within section 501(c)(3) of the Internal Revenue Code.

If you are in agreement with this proposed determination, we request that you sign and return the enclosed agreement, Form 6018. Please note the instructions for signing on the reverse side of the form.

Alternatively, if you are not in agreement with this proposed determination, we recommend that you request a hearing with our office of Regional Director of Appeals. Your request for a hearing should include a written appeal giving the facts, law and any other information to support your position, as explained in the enclosed Publication 892. You will then be contacted to arrange a date for a hearing. The hearing may be held at the office of Regional Director of Appeals or, if you request, at a mutually convenient District office. A self-addressed envelope is enclosed.

If we do not hear from you within 30 days from the date of this letter, and you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies and will then become our final determination.

Section 7423(b)(2) of the Internal Revenue Code provides, in part, that "declaratory judgment of decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

We have sent a copy of this letter to your representative as indicated in your power of attorney.

Sincerely yours,

Richard R. Brown
District Director

Copy To:

[Redacted]
[Redacted]
[Redacted]
[Redacted]

Enclosure:
Publication 892
Form 6018

Form 6018
(Rev. August 1983)

Department of the Treasury-Internal Revenue Service
Consent to Proposed Adverse Action
(All references are to the Internal Revenue Code)

Prepare in
Duplicate

Case Number

[REDACTED]

Date of Latest Determination Letter

Employer Identification Number

[REDACTED]

Date of Proposed Adverse Action Letter

Name and Address of Organization

[REDACTED]
[REDACTED]
[REDACTED]

I consent to the proposed adverse action relative to the above organization as shown by the box(es) checked below. I understand that if Section 7428, Declaratory Judgments Relating to Status and Classification of Organizations under Section 501(c)(3), etc. applies, I have the right to protest the proposed adverse action.

NATURE OF ADVERSE ACTION

- ☒ Denial of exemption as an organization described in section 501(c)(3) of the Internal Revenue Code.
- ☐ Revocation of exemption, effective
- ☐ Modification of exempt status from section 501(c)() to 501(c)(), effective
- ☐ Classification as a private foundation (section 508(a)), effective
- ☐ Classification as a non-operating foundation (section 4942(j)(3)), effective
- ☐ Classification as an organization described in section 508(a)(), effective
- ☐ Classification as an organization described in section 170(b)(1)(A)(), effective

If you agree to the adverse action shown above, please sign and return this consent. You should keep a copy for your records.

If you sign this consent before you have exhausted your administrative appeal rights, you may lose your rights to a declaratory judgment under section 7428.

(Signature instructions are on the back of this form.)

Name of Organization

Signature and Title

Date

Signature and Title

Date

Cat. No. 430000

Form 6018 (Rev. 8-83)